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9

10 UNITED STATES BANKRUPTCY COURT
11 FOR THE DISTRICT OF OREGON

12 In re
13 Peak Web, LLC,
14

15 Debtor.

16 _____
17 MACHINE ZONE, INC.,

18 Plaintiff,

19 PEAK WEB, INC.

20 Defendant.

21 _____
22 PEAK WEB, INC.

23 Plaintiff,

24 MACHINE ZONE, INC., EPIC WAR
25 LLC, and DOES 1 through 10, inclusive

Defendant.

Case No. 16-32311-pcm11

Adv. Pro. No. 16-03083-pcm

(Superior Court of California, County of Santa
Clara No. 15-cv-288498)

(Superior Court of California, County of Santa
Clara No. 15-cv-288681)

OBJECTION OF MACHINE ZONE, INC. TO
DEBTOR'S AMENDED MOTION FOR
ABSTENTION AND TO REMAND

23 The Litigation¹ between the Debtor and Machine Zone is, by the Debtor's admission,

24 inextricably linked to the Debtor's chapter 11 case. Machine Zone's damages claim against the

25 _____
26 ¹ The Debtor and Machine Zone are parties to two consolidated cases that were filed in state court in California: the
first-filed case, *Machine Zone, Inc. v. Peak Web, LLC*, No. 1-15-cv-288498 (Cal. Superior Ct., Santa Clara County);

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1 Debtor for breach of contract and fraud is approximately \$23 million, which would make
2 Machine Zone by far the Debtor's largest creditor. The Debtor's counter-assertions against
3 Machine Zone are for nearly \$100 million, which would be the largest asset of the Debtor's
4 estate, if the Debtor's claims had merit. The Litigation arises from disputes related to the
5 Debtor's former operation of a data center in Texas that provided network services to Machine
6 Zone under a services agreement executed in March 2015. After the Debtor caused a series of
7 devastating network outages at its data center that severely impacted Machine Zone's operations
8 and its revenue, Machine Zone terminated the agreement in accordance with its terms.

9 The Debtor's motion for abstention or remand should be denied. First, this Court ruled
10 that removal and the subsequent transfer to this District of the Litigation did not violate the
11 automatic stay, and therefore abstention does not apply. Second, the factors governing remand
12 favor this Court retaining jurisdiction over the Litigation. The Debtor's motion is based largely
13 on the unsupported premise that Machine Zone's desire to litigate this case away from its home
14 forum in Santa Clara County is a "tactical decision." In reality, it was the Debtor's decision to
15 move its headquarters to Oregon and then to file a bankruptcy petition in this Court that
16 materially altered the question of where the Litigation should proceed. Now that the Debtor has
17 elected to move its place of business to Oregon and to file its bankruptcy here, having the
18 Litigation also proceed here is the clear path to resolving both the bankruptcy and the Litigation
19 most efficiently. By the Debtor's own admission, the resolution of this bankruptcy case will
20 depend upon the outcome of the Litigation. In the context of plan confirmation, this Court will
21 be called upon to address issues relating to the Litigation, potentially including estimation of
22

23
24 and a subsequently-filed case, *Peak Web, LLC v. Machine Zone, Inc.*, et al., No. 1-15-cv-288681(Cal. Superior Ct.,
25 Santa Clara County) (collectively, the "Litigation"). Machine Zone removed the Litigation to the United States
26 Bankruptcy Court for the Northern District of California on June 27, 2016, and the parties stipulated to the transfer
of the Litigation to the District of Oregon on July 8, 2016. The parties' stipulation was approved on July 15, 2016,
and the Litigation was transferred to the District of Oregon. The District Court referred the Litigation to this Court
on July 21, 2016.

1 Machine Zone's claims against the Debtor.² Moreover, this Court is already more familiar with
2 the Debtor and with the disputes between the Debtor and Machine Zone than is the state court,
3 which has held only one *ex parte* hearing about seven months ago (denying the Debtor's request
4 for a TRO and a writ) and one case management conference. By contrast, this Court has already
5 held multiple hearings and issued several orders on motions related to the Litigation.

6 Certainly the state court judge is very capable of presiding over the Litigation. But given
7 the Debtor's decision to leave California for Oregon, its decision to file its chapter 11 case in this
8 district, and the inevitable overlap between the chapter 11 case and the Litigation, it will be much
9 more efficient, considerably less expensive, and will avoid duplication of effort by the parties
10 and the courts for the Litigation to proceed here in Oregon.

11 **I. Factual Background**

12 **A. The Parties**

13 Machine Zone is an innovator and developer of massively multiplayer, free-to-play
14 online games, including *Game of War: Fire Age* ("Game of War"). Game of War users
15 download the application (or app) on their mobile devices, build kingdoms and compete to "rule
16 the [virtual] world" while interacting in real-time with other players around the globe. First
17 released in July 2013, Game of War has been an immense success on a global scale earning a #1
18 ranking in Apple's app store. Epic War LLC is a California limited liability company that is
19 affiliated with Machine Zone and is listed as the developer of the game title Mobile Strike, which
20 has achieved success on a similar level to Game of War.

21 The Debtor (or "Peak") offers network infrastructure services. When Peak first filed its
22 Complaint against Machine Zone in this Litigation in December 2015, it alleged that its
23 headquarters were in Rancho Cucamonga, California. *See* Decl. of Sean M. Callagy, a copy of
24 which is attached hereto as Exhibit A ("Callagy Decl.") at ¶ 1 and Ex. 3. Peak now alleges in
25

26 ² Machine Zone's mentioning the possibility of an estimation proceeding is not intended as consent to any such
estimation, and Machine Zone reserves the right to object to any estimation motion.

1 this chapter 11 case that its headquarters are in Wilsonville, Oregon. The Debtor's principal,
2 Jeffrey Papen, who according to the Debtor will play a critical role in the Litigation, also works
3 and lives in Oregon. Callagy Decl. at ¶ 4 and Ex. 4.

4 **B. The Agreement**

5 The unique gameplay in Game of War and Mobile Strike takes place 24 hours a day, 7
6 days a week and requires players to take action in real-time. Because its games are free-to-play,
7 Machine Zone makes money only when players make in-game purchases. Thus, it is critical that
8 the game always be running; even short periods of downtime significantly harm Machine Zone's
9 ability to generate revenue. Accordingly, Machine Zone places a high premium on continuous
10 gameplay and insists on using data centers that follow so-called Tier IV standards, the most
11 robust level available. To induce Machine Zone to do business with it, Peak repeatedly and
12 emphatically assured Machine Zone of its expertise, referred Machine Zone to its alleged roster
13 of existing high profile clients, such as Uber, and represented to Machine Zone that it offered
14 data centers that followed those industry standard best practices and guaranteed that its network
15 would be "always up." In reliance on these representations, Machine Zone agreed to contract
16 with Peak to host its mobile games in Peak data centers.

17 In March 2015, Peak and Machine Zone negotiated the terms of a Master Services
18 Agreement (the "Agreement"). Callagy Decl. at ¶ 1 and Ex. 1. Machine Zone had the right to
19 terminate the Agreement for cause in the event of a "Material Breach" by Peak, if Peak failed to
20 meet a service level requirement three times in any calendar quarter. The Agreement also
21 provided that even single outages could accrue more than one "Strike." Thus, the Agreement
22 expressly gave Machine Zone the right to terminate if Peak did not perform as it promised it
23 would.

24 **C. Peak's Network Outages Force Machine Zone to Terminate the Agreement.**

25 Peak's representations turned out to be false. Machine Zone has later learned that Peak's
26 performance had been a continual issue for prior customers, including marquee customers Peak

1 highlighted in its effort to induce Machine Zone to sign up. Not surprisingly in retrospect, from
2 the beginning Machine Zone suffered significant problems with outages at Peak's data centers
3 caused by Peak's mistakes. Peak initially admitted to failing to comply with the Agreement.
4 However, as Peak's data centers continued to cause crashes, Peak began to refuse to
5 acknowledge its role in causing these outages, blaming them alternatively on Machine Zone or
6 on "bugs" in the software or hardware used by Peak. An audit of Peak's facilities revealed that
7 Peak was failing in multiple regards to adhere to standard practices for Tier-IV data centers—as
8 it had promised to do.

9 On October 27, 2015, Peak's substandard network architecture caused a massive
10 sequence of outages, which shut down Machine Zone's primary product for hours, causing
11 immediate loss of revenue, huge risks to customer retention, and expensive remediation efforts.
12 Peak's failures resulted in sufficient "Strikes" under the Agreement, triggering Machine Zone's
13 right to terminate the Agreement for cause. To prevent further harm to its business, Machine
14 Zone invoked its contractual right and provided notice of termination of Peak's services.³

15 To ensure the integrity of its game, Machine Zone migrated operations from Peak to a
16 data center in Las Vegas that had initially been planned as a disaster recovery back-up facility for
17 Peak's facility (with Peak's knowledge). Good thing, because moving to the Las Vegas data
18 center saved Machine Zone's business.⁴ Peak now alleges that Machine Zone used Peak's
19 (ambiguously defined) "trade secrets" and "proprietary information" to build the Las Vegas data
20 center—a contention that lacks any basis.⁵

21 ³ In November, Peak experienced multiple additional outages affecting Machine Zone, further confirming that
22 termination was warranted. Peak's attempt to dispute Machine Zone's right to terminate has been to try to blame
23 one of its equipment suppliers, Cisco. However, it is clear that Peak set up its systems incorrectly, causing the
24 service outages regardless of any supposed issues with Cisco.

25 ⁴ Machine Zone designed the Las Vegas data facility with the assistance of another company's "knowledge of
26 industry standard and manufacturer recommended best practices" without using or incorporating any features that
could be considered unique to Peak's data hosting facilities.

25 ⁵ The Agreement is a service agreement, not a license to intellectual property or other rights. As such, it expressly
26 contemplated that Machine Zone would have access to Peak's data centers to audit and supervise Peak. The
Agreement did not state anything about data center design or operations being confidential, and Peak never
identified *anything* about its operation as confidential during course of their business relationship. Moreover,

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1 **II. PROGRESS OF THE LITIGATION TO DATE**

2 **A. Commencement of the Litigation**

3 Seeking damages for the harm Peak caused it, and to confirm its right to terminate the
4 Agreement over Peak's protests, on November 25, 2015, Machine Zone filed its Complaint
5 against Peak in the Superior Court of California, County of Santa Clara. Callagy Decl. at ¶ 3.
6 Machine Zone alleges that Peak made false promises to induce it to hire Peak and that Peak's
7 substandard network architecture then failed to meet industry standards causing numerous
8 network outages, as described above. Machine Zone seeks approximately \$23 million in
9 damages and a declaration of its right to terminate the Agreement with cause.

10 Not willing to acknowledge that its own repeated network outages led to termination of
11 the Agreement, on December 3, 2015, Peak filed a responsive complaint against Machine Zone
12 and Epic War in the same court. Callagy Decl. at ¶ 3. Peak alleges that Machine Zone breached
13 the Agreement by terminating early and built its Las Vegas data center using Peak's trade secrets
14 and confidential information. Peak seeks over \$97.3 million in damages, based largely on the
15 theory that a penalty should apply to Machine Zone's termination of the Agreement, as well as
16 additional monetary damages. On January 4, 2016, the state court issued an order deeming the
17 case complex and staying discovery and response deadlines. Callagy Decl. ¶ 6 and Ex. 5. On
18 January 14, 2016, by stipulation, the cases were consolidated. Callagy Decl. at ¶ 7 and Ex. 6.

19 On January 15, Peak notified Machine Zone that it would appear *ex parte* to seek a TRO
20 unless Machine Zone immediately agreed to a stipulated TRO, and that it would move for a writ
21 of attachment. Callagy Decl. at ¶ 8 and Ex. 7. Machine Zone declined to agree and opposed the
22 *ex parte* applications – both of which the court then denied. Callagy Decl. at ¶ 9 and Ex. 8.

23 Peak's repeated efforts to characterize Machine Zone as obstructing mediation during the
24 discovery stay are false. Peak admits that its proposal for "early mediation" in December 2015

25
26 Machine Zone could have no conceivable interest in replicating a data center that was causing severe problems for
 its operations, and the vastly different design of Machine Zone's data center reflects that.

1 was conditioned on Machine Zone “stipulat[ing] to maintaining the status quo while [the parties]
2 attempt to mediate the dispute.” In other words, Peak’s proposal required Machine Zone to
3 stipulate to a baseless TRO (the TRO that the state court denied) and/or continue to use network
4 services whose failures were threatening to destroy Machine Zone’s business. Once the TRO
5 issue was resolved, Machine Zone *immediately* agreed to mediate. In March 2016, the parties
6 attended mediation but did not reach a settlement. Callagy Decl. at ¶ 10.

7 On March 25, 2016, the California court held an initial case management conference,
8 setting trial for March 2017 and lifting the stay on discovery. Since that time, the parties have
9 exchanged preliminary written discovery, but not a single document has been produced between
10 the parties and no depositions have occurred.⁶ Callagy Decl. ¶ 11. Neither party has answered
11 or otherwise responded to either Complaint.

12 **B. Peak Files for Bankruptcy**

13 On June 13, 2016, Peak filed a voluntary chapter 11 petition in this Court. While
14 Machine Zone is by far Peak’s largest creditor owing to its claims in the Litigation, Peak omitted
15 Machine Zone from its initial list of creditors and did not provide Machine Zone with notice of
16 its chapter 11 filing. Despite the exclusion of Machine Zone, the Litigation immediately took
17 center stage in this case. Along with customary first-day motions, Peak also filed two motions
18 directly related to the Litigation: (1) an application to employ special counsel to represent Peak
19 in the Litigation; and (2) a motion to obtain financing from an insider to pay Litigation expenses.
20 These motions contained a detailed discussion of the Litigation, including a discussion of the
21 nexus between the Litigation and the chapter 11 case.

22 The first day hearing in this Court on June 15, 2016 – which the Debtor elected not to
23 notify Machine Zone of – also focused largely on issues related to the Litigation. Peak made

24 _____
25 ⁶ In its discovery responses, it was Peak that has refused to produce even a single document; Peak instead responded
26 to all of Machine Zone’s requests for production of documents by either objecting *in toto* or saying that it is
“willing” to produce documents only *after* the parties have met and conferred about the scope of the request.
Callagy Decl. ¶ 11 and Ex. 9.

1 clear that its plan of reorganization would directly depend on the outcome of the Litigation: “As
2 a preview of what the plan’s going to be . . . we are going to give the unsecured creditors a piece
3 of the pie in the litigation, obviously. So the waterfall in the litigation will go to repay the
4 litigation loan, repay Bank of the West, and then pay all the unsecured creditors. So they are all
5 beneficiaries of this process.” Peak further explained that it expected to create a “litigation trust
6 and give the creditors’ committee a seat on that” so that they can “control the litigation.”

7 **C. Machine Zone’s Removal and Transfer of the Litigation to this Court**

8 In light of the Debtor’s move from California to Oregon, its bankruptcy filing in this
9 Court, the clear nexus between the chapter 11 case and the Litigation, and the fact that this Court
10 will inevitably be called upon to address matters relating to the Litigation, Machine Zone
11 determined that it would be most efficient to remove the Litigation to federal court and seek to
12 transfer it to this Court. Accordingly, on June 27, 2016, after notifying the parties and this Court
13 that it intended to do so, Machine Zone removed the Litigation to the Northern District of
14 California Bankruptcy Court, noting in its removal notice that it intended to seek transfer of the
15 Litigation to this district. Pursuant to the parties’ post-removal stipulation, the Northern District
16 of California Bankruptcy Court entered an order on July 15, 2016, transferring the Litigation to
17 the District of Oregon. The District Court referred the Litigation to this Court on July 21, 2016.
18 Peak filed the Motion for Abstention and to Remand on July 22, 2016 (and filed an amended
19 version on July 25). The California state court has vacated the trial date and all other deadlines
20 applicable to the Litigation in state court. Callagy Decl. at ¶ 12 and Ex. 10.

21 Peak initially agreed to stipulate, as part of the transfer of venue to this district, that it
22 would not allege that removal of the Litigation violated the automatic stay, but it later reneged on
23 that agreement. Accordingly, on July 8, 2016, Machine Zone filed a Motion for a Determination
24 That the Automatic Stay Does Not Preclude Removal of Litigation Between Debtor and Machine
25 Zone, Inc. or in the Alternative for Relief From the Automatic Stay to Permit Prior Removal and
26 Transfer of Venue (ECF No. 144) (the “Motion for Determination”), seeking a determination that

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1 removal of the Litigation and the subsequent transfer to this District did not violate the automatic
2 stay, or in the alternative seeking retroactive relief from the stay to permit removal and transfer of
3 venue. The Court granted the Motion for Determination by oral ruling on August 4, 2016,
4 concluding that removal and the subsequent transfer of the Litigation did not violate the
5 automatic stay. Because the Litigation has been removed from state court, there is no longer a
6 pending state court proceeding.

7 **MACHINE ZONE'S OBJECTION TO DEBTOR'S MOTION TO REMAND**

8 **III. Abstention Does Not Apply Once Litigation Is Removed from State Court.**

9 Once a proceeding has been removed from state court, abstention under 28 U.S.C. § 1334
10 no longer applies because removal extinguishes the predicate state court action. *Schulman v.*
11 *California (In re Lazar)*, 237 F.3d 967, 981 (9th Cir. 2001) (upon removal of a state court action,
12 no state proceeding exists, “[a]ccordingly, because there is no pending state proceeding,
13 §§ 1334(c)(1) and 1334(c)(2) are simply inapplicable to this case.”); *Security Farms v. Int'l Bhd.*
14 *of Teamsters*, 124 F.3d 999 (9th Cir. 1997) (“Abstention can exist only where there is a parallel
15 proceeding in state court.”).⁷ The doctrine set forth in *Lazar* and *Security Farms* applies to both
16 mandatory and discretionary abstention. *Lazar* and *Security Farms* both specifically cited
17 28 U.S.C. § 1334(c)(1), discretionary abstention, and 28 U.S.C. § 1334(c)(2), mandatory
18 abstention. *In re Lazar*, 237 F.3d at 981; *Security Farms*, 124 F.3d at 1010 (“Section 1334(c)
19 abstention ... applies only in those case in which there is a related proceeding that either permits
20 abstention in the interest of comity, section 1334(c)(1), or that, by legislative mandate, requires

21
22 ⁷ See also *McDowell Welding & Pipefitting, Inc. v. U.S. Gypsum Co.*, 285 B.R. 460, 475 (D. Or. 2002) (“[t]he
23 mandatory and permissive abstention principles of § 1334 apply only in cases in which there is a related proceeding
24 pending in state court ... [w]hen a case has been removed to federal court, the state case ceases to exist and § 1334
25 is no longer applicable.”); *In re Roman Catholic Bishop of San Diego*, 374 B.R. 756, 760 (Bankr. S.D. Cal. 2007)
26 (“on two occasions the Ninth Circuit has held the abstention doctrine is inapplicable if there is no parallel
proceeding in the state court ... [t]he Debtor’s removal of these actions from the state court means there is no longer
a parallel state court proceeding. Accordingly, as a matter of law, abstention is in applicable.”); *In re Roman
Catholic Archbishop of Portland in Or.*, 338 B.R. 414, 420 (Bankr. D. Or. 2006) (“as the parties recognize, in the
Ninth Circuit, abstention is not applicable once a proceeding is removed to federal court, because there is no
pending state court proceeding.”).

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1 it, section 1334(c)(2)."); *see also McDowell*, 285 B.R. at 475. This Ninth Circuit precedent
2 prohibits consideration of the Debtor's abstention motion as a matter of law. *In re Roman*
3 *Catholic Bishop of San Diego*, 374 B.R. at 760. The Debtor's counsel acknowledged as much at
4 the July 27, 2016 hearing on the Motion for Determination: "Based on Ninth Circuit law, I agree
5 that if both cases have been removed we would not be able to argue mandatory abstention."
6 Transcript of July 27, 2016 Hearing, audio at 47:10-16.

7 Because Machine Zone removed the Litigation from state court, and this Court held that
8 such removal was not precluded by the automatic stay, under *Lazar* and *Security Farms* there is
9 no pending state court action with respect to which this Court can consider the Debtor's
10 abstention motion. Abstention is inapplicable as a matter of law, and the Court should therefore
11 deny the Debtor's abstention request.

12 **IV. The Court Should Deny the Debtor's Remand Request.**

13 The Court should also deny the Debtor's remand request. Courts have discretion in
14 considering a remand request, and in doing so generally apply a multi-factor analysis. *In re*
15 *Sequoia Village, LLC*, 2012 WL 478926 at *1 (Bankr. D. Or. Feb. 14, 2012).⁸ When a state law
16 proceeding has been removed to bankruptcy court from state court, courts in the Ninth Circuit
17 generally consider the following "*Cedar Funding*" factors in deciding a remand motion:

- 18 (1) the effect or lack thereof on the efficient administration of the estate if the court
19 remands;
20 (2) the extent to which state law issues predominate over bankruptcy issues;
21 (3) whether there are difficult or unsettled issues under applicable law;
22 (4) the presence of any related proceeding commenced in state court or other non-
23 bankruptcy proceedings;
24 (5) whether there is any jurisdictional basis other than 28 U.S.C. § 1334;
25 (6) the degree of relatedness of the proceeding to the main bankruptcy case;
26 (7) the substance, rather than the form, of an asserted core proceeding;
27 (8) the feasibility of severing state law claims from core bankruptcy matters to allow
28 state court judgments to be enforced by the bankruptcy court;

⁸ Were the Court to hold that discretionary abstention was applicable in this case, the same analysis would apply. *Fed. Home Loan Bank of Chicago v. Banc of Am. Securities LLC*, 448 B.R. 517, 525 (C.D. Cal. 2011) (same factors apply to remand and discretionary abstention); *In re Roman Catholic Archbishop of Portland in Or.*, 338 B.R. 414, 420 (Bankr. D. Or. 2006). However, as discussed above, abstention is inapplicable as a matter of law.

- (9) the burden on the bankruptcy court's docket;
 - (10) the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties;
 - (11) the existence of a right to jury trial;
 - (12) the presence of non-debtor parties in the proceeding;
 - (13) comity; and
 - (14) the possibility of prejudice to other parties in the action.

Nilson v. Neilson (In re Cedar Funding, Inc.), 419 B.R. 807, 820 n.18 (B.A.P. 9th Cir. 2009); *In re Roman Catholic Archbishop of Portland in Or.*, 338 B.R. at 420. Here, each of the factors, to the extent it is applicable, favors denial of remand.

A. Denying Demand Will Allow More Efficient Administration of the Estate.

This Court should retain jurisdiction of the Litigation because doing so will result in more efficient administration of the Debtor’s estate. “The ‘centralized resolution of bankruptcy claims’ and ‘the avoidance of piecemeal litigation’ are fundamental purposes of the Bankruptcy Code.” *In re Rader*, 488 B.R. 406, 416 (B.A.P. 9th Cir. 2013). Here, the Debtor believes that the Litigation is a critical element of its bankruptcy case, Tr. of June 15, 2016 Hearing at 32:3-11. Machine Zone agrees. Resolution of the Litigation could result in Machine Zone holding a \$23 million claim against the Debtor, making Machine Zone by far the largest creditor.

Alternatively, if the Debtor were to obtain a recovery against Machine Zone, any such recovery would be property of the estate. Either way, the Litigation will have substantial impact on the Debtor's estate, and the size of the potential claims justifies denial of remand. *Senorx, Inc. v. Coudert Bros., LLP*, 2007 WL 1520966 at *3 (N.D. Cal. May 24, 2007) (denying motion to remand in part because "the resolution of this case will have a significant effect on the bankruptcy estate ... [t]he large amount of money at stake in this litigation has the potential to greatly reduce the bankruptcy estate and constitutes a significant potential liability for the debtor."); *In re Neel*, 2016 WL 3922904 at *4 (Bankr. D. Or. June 14, 2016); *In re Sequoia Village, LLC*, 2012 WL 478926 at *2 (Bankr. D. Or. Feb. 14, 2012) ("As the bankruptcy cases... depend on the outcome of the matters under litigation, it would serve the best interests of both bankruptcy estates if the matter were heard by the same court with the same time table."); *In re*

1 *AmericanWest Bancorporation*, 2011 WL 6013779 at *2-3 (Bankr. E.D. Wash. Dec. 2, 2011)
2 (where litigation claims would have a substantial impact on creditor recoveries, the effect of the
3 litigation on the bankruptcy favored denial of remand).

4 As a result of the proceedings to date (including several motion hearings relating
5 specifically to the Litigation), this Court has been provided substantial background concerning
6 the Litigation, as well as information concerning the Debtor and its business, its principal, its
7 financing, its creditors, other parties in the case. At this point, this Court is far more familiar
8 with the Debtor's circumstances, as well as with the Litigation, than the state court, which held
9 only the *ex parte* hearing seven months ago and one case management conference in March, and
10 has since vacated all deadlines, including the trial date. Callagy Decl. ¶ 12 and Ex. 10. As the
11 Debtor's chapter 11 case proceeds, the Court will continue to gain familiarity with the Debtor
12 and with issues bearing on the Litigation. As a result, this Court will be in as good, or better,
13 position than a state court to conduct the Litigation. *See In re Maria Vista Estates*, 2016 WL
14 1381769 at *12 (Bankr. C.D. Cal. Apr. 5, 2016) (bankruptcy court stated that because of its
15 familiarity with the debtor, "retention of the proceeding will promote judicial economy and
16 facilitate the efficient administration of the ... bankruptcy case.").

17 Indeed, even if the Litigation were to be remanded to state court, this Court is likely to be
18 called upon to delve into its merits, including in connection with Machine Zone's ability to vote
19 its \$23 million claim on a plan (potentially including "temporary allowance" issues under
20 Bankruptcy Rule 3018(a)), the status of Machine Zone's claim as secured or unsecured under a
21 plan in light of the right of setoff, potential claim estimation proceedings under section 502(c) of
22 the Bankruptcy Code, Machine Zone's treatment under a plan, feasibility issues which may
23 depend upon an evaluation of the Litigation, and in other respects. Remand would thus result in
24 two different courts dealing with the Litigation. That is not efficient.

25 For all of these reasons, this Court is the most efficient venue for the Litigation to
26 proceed. Retaining jurisdiction over the Litigation will further the bankruptcy policy of

1 providing a forum for the “centralized resolution of bankruptcy claims” and “the avoidance of
2 piecemeal litigation.” *In re Rader*, 488 B.R. at 416.

B. This Court Can Determine and Apply State Law in the Litigation.

The second and third *Cedar Funding* factors – the “extent to which state law issues predominate over bankruptcy issues,” and the “difficult or unsettled nature of applicable law” – do not support remand of the Litigation. “Despite the presence of state law claims and the need to interpret a state statute, bankruptcy courts are capable of resolving issues of state law” *Senorx, Inc. v. Coudert Bros., LLP*, 2007 WL 1520966 at *3. As the Debtor acknowledged, “there is no doubt that this Court is capable of determining issues of state law.” Motion at 17.

The Litigation involves “state law claims [that] are not unusual and are well settled,” and “are the type of issues commonly alleged in commercial litigation.” *In re AmericanWest Bancorporation*, 2011 WL 6013779 at *3-4. Machine Zone seeks a declaratory judgment that it properly terminated its agreement with the Debtor and damages resulting from the Debtor’s failure to perform, and the Debtor seeks damages from Machine Zone for its alleged wrongful termination of the agreement, as well as for the alleged misappropriation of trade secrets. The contract claims are straightforward issues involving contractual interpretation and the calculation of damages, if any, owed to either party. Bankruptcy courts are frequently called on to determine parties’ contractual rights and resulting damages under applicable non-bankruptcy law, whether as part of the claims allowance process, in connection with motions to assume or reject executory contracts or, as here, in adversary proceedings. There is no reason that this Court cannot resolve similar issues with respect to the contractual dispute between Machine Zone and the Debtor.

With respect to the “trade secret” claims, there is a well-established body of case law to guide the Court. Much of the law governing Peak’s trade secret claim is not unique to California, as the California statute is based largely on the Uniform Trade Secrets Act, which both California and Oregon (and nearly all other states) have adopted. *See Vesta Corp. v.*

1 *Amdocs Mgmt. Ltd.*, 129 F. Supp. 3d 1012, 1039 (D. Or. 2015) (granting motion to transfer under
2 28 U.S.C. § 1404 and noting that “while the parties vigorously argue about which state law
3 applies to the trade secret misappropriation claim, both Texas and Oregon have adopted the
4 Uniform Trade Secrets Act (‘UTSA’) and thus the laws of both states are likely to yield the same
5 results.”); *Computer Econ., Inc. v. Gartner Grp.*, 50 F. Supp. 2d 980, 983 (S.D. Cal. 1999)
6 (California is “one of many states to adopt the Uniform Trade Secrets Act”). Contrary to the
7 Debtor’s suggestion, there is ample precedent on the trade secret and confidentiality matters at
8 issue in the Litigation, and this Court is fully capable of applying that well-established precedent
9 to the facts of the Litigation. Indeed, there are many instances in which bankruptcy courts have
10 decided trade secret cases.⁹

11 **C. There Is No Related Proceeding in State Court.**

12 The fourth *Cedar Funding* factor weighs against remand. As discussed above, under
13 Ninth Circuit precedent, once a proceeding is removed from state court, there is no longer a state
14 court proceeding. *See supra*, Section III. This Court held that the removal of the Litigation was
15 valid and not prohibited by the automatic stay. Accordingly, there is no pending state court
16 proceeding related to the Litigation and this factor weighs against remand.

17
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19 ⁹ *See, e.g., In re RnD Eng’g, LLC*, 546 B.R. 738 (Bankr. E.D. Mich. 2016) (conducting trial and rendering judgment
20 on claims against debtors for misappropriation of trade secrets under Michigan Uniform Trade Secrets Act); *Messer*
21 *v. Collins (In re Collins)*, 540 B.R. 54 (Bankr. E.D.N.Y. 2015) (finding trustee’s allegations sufficient to state a
22 claim for misappropriation of trade secrets under New York law); *Khatib v. Sun-Times Media Grp., Inc. (In re*
23 *Chicago Newspapers Liquidation Corp.*, 490 B.R. 487 (Bankr. D. Del. 2013) (dismissing claim against debtors’
24 liquidating trust for trade secret misappropriation under Illinois Trade Secrets Act); *TXCO Res., Inc. v. Peregrine*
25 *Petroleum, LLC (In re TXCO Res., Inc.)*, 475 B.R. 781 (Bankr. W.D. Tex. 2012) (conducting trial and rendering
26 judgment on debtor’s claims for misappropriation of trade secrets under Texas law); *Maxxim Med., Inc. v. Prof’l*
27 *Hosp. Supply, Inc. (In re Maxxim Med. Grp., Inc.)*, 434 B.R. 660 (Bankr. M.D. Fla. 2010) (conducting trial and
28 rendering judgment on debtor’s claims for breach of contract and misappropriation of trade secrets under Florida’s
29 Uniform Trade Secrets Act); *In re Cross Media Mktg. Corp. v. CAB Mktg., Inc. (In re Cross Media Mktg.)*, 367 B.R.
30 435 (Bankr. S.D.N.Y. 2007) (conducting trial and rendering judgment on debtors’ claims for misappropriation of
31 customer lists and other trade secrets); *Am. Preferred Prescription, Inc. v. Health Mgmt., Inc. (In re Am. Preferred*
32 *Prescription, Inc.)*, 186 B.R. 350 (Bankr. E.D.N.Y. 1995) (ruling on debtor’s preliminary injunction motion seeking
33 to enjoin another party from disclosing trade secrets).

1 **D. This Court May Have Jurisdiction Apart From 11 U.S.C. § 1334.**

2 The fifth *Cedar Funding* factor also favors denial of the Debtor's remand motion because
3 there may be diversity of citizenship among the parties to the Litigation, giving rise to federal
4 jurisdiction under 28 U.S.C. § 1332. The Debtor is a limited liability company, so its location,
5 for diversity purposes, is determined by the domicile of its members. *See Johnson v. Columbia*
6 *Props. Anchorage, L.P.*, 437 F.3d 894, 899 (9th Cir. 2006) ("an LLC is a citizen of every state of
7 which its owners/members are citizens"). The Debtor's members are Mr. Papen, who has stated
8 that his domicile is in Oregon, and FWH Holdings, LLC, which appears to be a Delaware limited
9 liability company.¹⁰ Machine Zone is located in California.¹¹ This would create complete
10 diversity. If one were to look through FWH Holdings, LLC, for diversity purposes, the Debtor
11 has advised that its sole member is Fred Hsu. Mr. Hsu was a Washington resident.¹² The Debtor
12 has recently asserted that Mr. Hsu changed his domicile to California. Without conceding that it
13 would be appropriate to look through FWH Holdings, LLC for diversity purposes, Machine Zone
14 has served discovery requests relating to the assertion that Mr. Hsu has changed his domicile
15 from Washington to California. Callagy Decl. at ¶ 14 and Ex. 12. As of the date of this filing,
16 Machine Zone has not received responses to its discovery requests. Thus, the existence of
17 complete diversity in this case is uncertain, and potentially subject to dispute.

18 Even where the only basis for jurisdiction is 28 U.S.C. § 1334, "[l]iquidating ... claims
19 for purposes of distribution, although non-core, is central to the completion of the administration
20 of" bankruptcy estates. *In re Roman Catholic Archbishop of Portland in Or.*, 338 B.R. at 421.

21 **E. The Litigation Is Closely Related to This Bankruptcy Case.**

22 The sixth *Cedar Funding* factor supports denial of remand because, as noted above, the
23 damages alleged in the Litigation are potentially among the Debtor's largest assets and liabilities,

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¹⁰ Available at <https://icis.corp.delaware.gov/Ecorp/EntitySearch/NameSearch.aspx> (type "FWH Holdings, LLC" in
25 Entity Name box).

¹¹ See Exhibit B hereto.

¹² Callagy Decl. at ¶ 13 and Ex. 11.

1 and the outcome of the Litigation will have a significant – perhaps dispositive – impact on the
2 Debtor’s bankruptcy case. The transcript from the first-day hearing reflects the Debtor’s and the
3 first lien lender’s views that the Litigation is a key matter in the chapter 11 case. *See, e.g.*, Tr. at
4 6, 19.

5 Machine Zone’s claim for approximately \$23 million, including any associated right of
6 setoff, will have to be dealt with in any chapter 11 plan that may be proposed by the Debtor. In
7 addition, as discussed above, this Court may be asked to estimate Machine Zone’s claim
8 pursuant to Section 502(c) of the Bankruptcy Code and/or to address temporary allowance of
9 Machine Zone’s claim for voting purposes under Rule 3018(a) of the Federal Rules of
10 Bankruptcy Procedure. And, to the extent the Debtor obtains any recovery from Machine Zone
11 in excess of Machine Zone’s recovery from the Debtor, that could be a source of funding for
12 payment of creditors. The Court may also need to evaluate the Litigation in connection with a
13 plan feasibility analysis and potentially also in connection with other confirmation issues.
14 Indeed, it is unlikely that the Debtor’s bankruptcy will be resolved *without* resolution of the
15 Litigation. Under these circumstances, “[a] closer connection is virtually unimaginable.” *In re*
16 *Neel*, 2016 WL 3922904 at *5 (noting close connection of removed litigation to the debtor’s
17 bankruptcy case as a factor weighing against remand).

18 **F. The Litigation Is Not a Core Proceeding.**

19 Neither the Debtor nor Machine Zone assert that the Litigation is a core proceeding,
20 accordingly it is not necessary to determine “the substance rather than the form of an asserted
21 core proceeding,” and this factor does not apply. *In re Roman Catholic Archbishop of Portland*
22 *in Or.*, 338 B.R. 421 (factor requiring analysis of the substance of “asserted core proceeding” is
23 inapplicable where the proceeding is non-core).

24 **G. There Is No Benefit to Severing State Law Matters.**

25 Whether it is feasible to sever state law matters, there is no benefit to doing so in light of
26 the inextricable relationship between the Litigation and the Debtor’s bankruptcy case. There

1 would be no advantage to the Court, the parties to the Litigation, or the Debtor's creditors in
2 putting the Debtor's bankruptcy in limbo while the Litigation is remanded to state court, only to
3 have the ultimate outcome of that Litigation enforced in this Court. Retaining jurisdiction over
4 the Litigation will permit this Court to schedule hearings, set deadlines, and otherwise administer
5 the Litigation and the Debtor's bankruptcy case in a uniform manner, without the inefficiency
6 inherent in attempting to coordinate proceedings with the state court.

7 **H. The Litigation Will Not Unduly Burden the Bankruptcy Court's Docket.**

8 Retaining jurisdiction over the Litigation will require some of this Court's resources. But
9 that fact cannot possibly be a basis for remand, or else every removed case would be remanded,
10 because every litigation takes up some of the court's time. This Litigation should not unduly
11 burden the Court's docket; it is a discrete dispute focused on issues of contractual interpretation.
12 Machine Zone intends to conduct the Litigation efficiently and in a manner calculated to avoid
13 unnecessary disputes. Indeed, efficiency and avoidance of duplicated effort was the motivation
14 behind Machine Zone's decision to remove and to seek transfer of the Litigation. While the
15 amounts at stake in the Litigation are substantial, Machine Zone does not anticipate that the
16 Litigation would require an inordinate amount of the Court's time, in comparison to other
17 complex civil litigation matters that the Court doubtless has had before it.¹³

18 Moreover, given the relationship between the Litigation and the Debtor's bankruptcy
19 case, it is inevitable that this Court would have significant involvement with issues relating to the
20 Litigation even if the Litigation were remanded. In addition to the issues discussed above that
21 are likely to arise in connection with plan confirmation – which will require the Court's
22 substantive attention to the Litigation and Machine Zone's claims therein – this Court will be

23
24 ¹³ The Debtor points out that if the Litigation were to go to trial, it would likely require some of the District Court's
25 time as well, since a jury trial would presumably be conducted in the District Court rather than in this Court. *See*
26 Motion at 19. However, in light of the order of reference, we assume this Court would preside in the first instance
over pre-trial matters, *see* District Court Local Rule 2100-8(a), and if the Litigation were to go to trial, it should not
be a particular burden on the District Court, which routinely presides over similar – and often significantly more
complex – cases.

1 also called upon to address applications for professional retention and compensation relating to
2 the Litigation, matters regarding financing of the Litigation (including the recently-raised issues
3 regarding Mr. Papen's initially undisclosed potential involvement in that financing), and
4 consideration under Bankruptcy Rule 9019 of any settlement that may be reached in the
5 Litigation. Counsel for the other major parties in the chapter 11 case, including the creditors'
6 committee and Bank of the West, are located in Oregon and will surely be interested in the
7 Litigation, given the size and importance of the parties' claims. If the Litigation is pending in
8 this Court, it will be easier for those and other interested parties to monitor the proceedings and
9 attend hearings as they deem appropriate. Given the central role that the Litigation will play in
10 the chapter 11 case, that fact weighs against remand.

11 **I. Removal of the Litigation To This Court Was Not Forum Shopping.**

12 Machine Zone did not remove this action in order to "forum shop" or obtain some sort of
13 strategic litigation advantage. Indeed, Machine Zone has prevailed thus far in state court. But,
14 the Debtor chose to move to Oregon and to file bankruptcy in this District, and Machine Zone
15 removed the Litigation because it believed it would be more efficient for the Litigation to
16 proceed in the same forum as the Debtor's bankruptcy case, particularly in light of the close
17 relationship between the Litigation and the Debtor's bankruptcy.¹⁴ Far from forum shopping,
18 removal is consistent with the principle that "[t]he 'centralized resolution of bankruptcy claims'
19 and 'the avoidance of piecemeal litigation' are fundamental purposes of the Bankruptcy Code."
20 *In re Rader*, 488 B.R. 406, 416 (B.A.P. 9th Cir. 2013). In addition, the Debtor's reliance on an
21

22 ¹⁴ The Debtor appears to have moved its headquarters from California to Oregon, presumably for the purpose of
23 being able to have the chapter 11 case proceed in Oregon as a more convenient venue, close to where its principal –
24 Jeffrey Papen – who the Debtor has represented is central to the Litigation – resides. But, having done so, the
25 Debtor now seeks to avoid litigating in Oregon. In fact, the Debtor has made contradictory allegations regarding its
26 headquarters: the Debtor alleged in its state court Complaint in December 2015 that it was headquartered in California, Callagy Decl. at ¶ 4, but has since disclosed in this chapter 11 case that it was headquartered in Oregon at the same time. *See Statement of Financial Affairs* (ECF No. 112), at 6. The Debtor cannot credibly claim to be headquartered in two different states at the same time, one a more convenient forum for its chapter 11 case but not a convenient forum for Litigation that, by its own admission, is inextricably linked to the chapter 11 case, and the other a more convenient forum for the Litigation but not for the chapter 11 case.

1 alleged forum selection clause in the Agreement is incorrect. The Agreement contained no such
2 forum selection clause, but rather, a choice of law provision. Callagy Decl., Ex. 1 § 17.

J. The Right to a Jury Trial Does Not Support Remand.

4 Remand is not necessary to preserve either party’s right to a jury trial. The District
5 Court’s rules recognize the ability of this Court to determine whether the right to a jury trial
6 exists and, if so, to conduct jury trials upon consent of the parties and approval by a District
7 Court judge. D. Or. L. R. 2100-8(a). If the parties do not consent, or the District Court judge
8 does not approve a jury trial in this Court, the same rule provides that the bankruptcy court will
9 conduct pretrial proceedings “up through lodging of the pretrial order, unless reference is
10 withdrawn.” *Id.* Thus, remand to the California state court is not necessary to protect the
11 parties’ jury trial rights.

K. The Only Parties to the Action Are Machine Zone and the Debtor.

13 The twelfth and fourteenth *Cedar Funding* factors – the presence of non-debtor parties
14 and the possibility of prejudice to other parties – do not support remand. The only parties to the
15 Litigation are Machine Zone and the Debtor. There are no other parties to the Litigation that
16 could be prejudiced by conducting the Litigation in this Court.

17 As noted above, counsel for the other major parties in the chapter 11 case, including the
18 creditors committee and Bank of the West, are located in Oregon. If the Litigation is pending in
19 this Court, it will be easier for those and other interested parties to monitor the proceedings and
20 attend hearings as they deem appropriate. Given the central role that the Litigation will play in
21 the chapter 11 case, that fact weighs against remand.

L. Comity Does Not Support Remand.

When a case has not progressed significantly in state court, courts generally regard comity as a neutral factor that does not weigh in favor of remand. *Stichting Pensioenfonds ABP v. Countrywide Fin. Corp.*, 447 B.R. 302, 312 (C.D. Cal. 2010) (comity did not require remand of a case that was “in its infancy and was removed before any motions to dismiss or responsive

1 pleadings were filed.”); *Senorx v. Coudert Bros., LLP*, 2007 WL 1520966 at *3 (N.D. Cal. May
2 24, 2007) (“Comity does not favor remand in this case. Though the case was before the state
3 court for some time, the court had not made significant progress.”); *Cox v. Holcomb Fam. Ltd.*
4 *P’ship*, 2015 WL 128001 at *2 (Bankr. D. Or. Jan. 8, 2015) (“I do not think comity is implicated
5 here, where the complaint was removed from state court promptly … Comity is a neutral
6 factor.”); *In re Maria Vista Estates*, 2016 WL 1381769 at *14 (Bankr. C.D. Cal. April 5, 2016)
7 (comity does not warrant remand when a case had been pending in state court for only a short
8 time). The Litigation was in the early stages at the time of the Debtor’s bankruptcy petition and
9 the subsequent removal of the Litigation to this Court, and all deadlines, including the trial date,
10 have since been vacated by the state court. Accordingly, comity does not support remand.

11 **CONCLUSION**

12 For the foregoing reasons, Machine Zone respectfully requests that the Court deny the
13 Debtor’s remand and abstention motion, retain jurisdiction over the Litigation for further
14 proceedings in this Court, and afford such other relief as is just and appropriate.

15 DATED: August 8, 2016

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CERTIFICATE OF SERVICE

I hereby certify that on the date set for the below I electronically filed the foregoing

OBJECTION OF MACHINE ZONE, INC. TO DEBTOR'S AMENDED MOTION FOR ABSTENTION

AND TO REMAND with the Clerk of Court using the CM/ECF system, which will send a notice of

electronic filing to all CM/ECF participants, and I served a true and correct copy of the foregoing,

by standard first class mail to the following:

J. Mark Thacker
Ropers, Majeski, Kohn & Bentley
50 W. San Fernando St #1400
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DATED this 8th of August, 2016

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